

Case Study 2 (Hypothetical): Lebanon's VAT tax is increased from 10% to 15%

On October 1, 2011, Parliament is expected to pass a regulation to increase the Value Added Tax (VAT)¹ from 10% to 15%. The regulation states that the VAT exemption will continue to apply on a variety of items including: staple foods, education, precious metals and jewelry, yachts, air transportation and gambling. The Treasury will continue to be accountable for the VAT collection and businesses are still required to file tax returns every quarter. The increase will go into effect on January 1, 2012.

According to analysts, the VAT has become the main source of income for the cash-strapped government, which uses the funds from the tax to reduce the annual budget deficit. The VAT revenues are estimated at over \$1.5 billion per year.

The proposed regulation has triggered widespread protests from trade unions, consumer groups and even taxi drivers, who have issued concerns about the consequences on the overall state of the economy and on the price of commodities. The president of Consumer Lebanon has vocally objected to the increase in the VAT: "We know very well that the government is preparing the public for higher taxes but I can assure you that such a tax will be detrimental. Since the year 2000, taxes in Lebanon have increased by a total of 366 percent while minimum wages rose by only 66 percent."

Human rights groups are arguing that an increase in the VAT will disproportionately affect the poor and result in these segments of the population bearing most of the costs. As noted, the tax does not apply to luxury goods and could impact lower income consumers in their purchases of their daily "necessities" or staple goods. An increase in the VAT may lead to a decrease in retail sales overall.

The VAT increase could have a significant impact on businesses.² Certain business owners face the dilemma of whether the added cost of the tax can be passed on to the consumer: they may face the choice of either having to increase their prices to cover the increase in VAT or accepting a reduction in profit margins by absorbing the increase themselves. Any increase in prices will be a direct cost to the consumers. In addition, an increase in the VAT will place an additional burden on VAT registered businesses as they will have to deal with the administrative and compliance aspects of a change in the standard rate of VAT.

Some economists are arguing that increasing the VAT at this time runs the risk of a downturn in the economy when the economic recovery in Lebanon is still fragile. Recent research shows that a VAT increase to 15% could result in a loss of up to 15,000 jobs and in the closure of retail establishments. Economists recognize that there may be some short term benefits from an increase in the VAT such as a reduction in Lebanon's budget deficit but these benefits will be temporary.

The VAT increase will result in significant costs and some benefits. Some of that impact has been estimated using an economic model and the data is provided below.

¹ A VAT is often considered to be a retail sales tax. However, a VAT differs from a retail sales tax in that it is collected at each stage of the production and distribution process, not solely at the "point of sale" when a product is sold to the consumer.

² The amount of the VAT a firm pays can result in an increase in the prices of the firm's products or services. The VAT will also be levied on capital goods, raw materials, spare parts, services etc., which businesses use in their production processes

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Treasury Revenue (millions)	100	103	106	108	110	113	115	118	121	123	125
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Budget Deficit (millions)	1626	1610	1609	1607	1606	1605	1608	1610	1614	1618	1620
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Retail Sales (millions)	626	610	609	607	606	605	608	610	614	618	620
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Number of Jobs in the Retail Sector (thousands)	67	65	63	55	54	55	55	56	59	61	63